



UK House Price Forecasts

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OVERVIEW

- At the beginning of 2010 we forecasted a year of two halves for the UK housing market. We expected the level of market optimism gradually to fade, with house price growth slowing towards the end of 2010. This prediction appears to be bearing out, with most indicators of house price growth now starting to show signs of weakening.
- It is clear that the banking crisis has caused a seismic shift in the mortgage market. The difficulties in getting a loan are still prevalent, despite a slight easing in credit. This situation may worsen as the Bank of England support is withdrawn and banks continue to re-finance.
- Our mid year forecasts suggest house prices will rise by 3% over 2010 as a whole. However, minor house price falls are likely over the subsequent two years as the major public spending cuts feed through to the wider economy.

INTRODUCTION

In February 2009 UK house prices reached their lowest level since 2004. But since then prices have steadily increased, growing by over 15% in the last 17 months; they are now only 8.6% below the October 2007 peak. To many optimistic commentators this signalled the start of the housing market recovery. However, the price pick-up was not associated with a marked revival in activity and largely reflected a demand and supply imbalance. In particular, while an underlying, albeit limited, level of demand was sustained, the stock of marketed properties significantly fell; low interest rates have helped keep down repossessions and forced selling.

In recent months however, the pick-up in house prices has fed through to improved confidence and a pick-up in sellers. This was further engendered by the abolition of Home Information Packs (HIPs). But, it has not been matched by a rise in demand - many buyers still face credit constraints. As a result the supply and demand balance has shifted. In May the ratio of buyers to sellers fell to its lowest level since August 2009. This has led to the dramatic slowing of house price growth.

In a thin market with few transactions, shifts in price movements are quite common and can reflect quite small shifts in demand and supply rather than the wider economic backdrop.

However, going forward we think macro-economic factors will come back into play. The coalition government faces the unenviable task of reducing the budget deficit while still maintaining the momentum in the economic recovery. To this end the emergency budget outlined a £113bn fiscal tightening by 2015. There is no doubt these budget policies will feed through to, at best, a short-term increase in unemployment and fall in household income. This will have a major impact on the future trajectory of the housing market.

In this paper we examine the economic prospects and what it means for house prices. Our analysis suggest house prices will fall slightly over the next six months, and end the year just 3% higher than at the start of the year. The combination of higher taxes, interest rates and unemployment will act as a continued drag on house prices over the next two years with no significant upward movement in prices until 2013.

Table 1: UK House Price Forecasts

	2009	2010	2011	2012	2013	2014
Average House Price	£162,116	£166,980	£163,640	£163,640	£168,549	£176,977
Annual House Price Growth	6%	3%	-2%	0%	3%	5%

Table 2: Economic Assumptions

	2010	2011	2012	2013
Base Rate	1.0	2.5	3.5	4.0
RPI	4.1	3.4	3.2	3.0
Earnings Growth	2.2	2.5	2.6	3.3
Unemployment Growth	4.1	-3.8	-17.3	-15.7
GDP Growth	1.3	2.4	3.0	2.6

INTEREST RATES

Our base case assumption is the MPC will begin the gradual process of interest rate normalisation towards the end of the year, with further and more significant rises taking over the next three years, taking base rate to 4% by the end of 2013.

The resulting increase in mortgage rates will have a significant impact on the housing market. Interest rates are currently at an all time low and have led to fewer repossessions and more manageable monthly payments. According to Moneyfacts, in June 2010, the average 2 year fixed rate mortgage fell to its lowest level since September 2003. Increasing base rate over the next three years, will reverse these benefits and price some buyers out of the market.

The future path of interest rates is uncertain and some commentators do not expect any increase until 2011, with the MPC keeping rates lower than our assumption in the medium term in order to offset the impact of the severe fiscal squeeze. This could provide an upside scenario for the housing market, with continued low rates offering a supporting counterbalance to the negative effects of fiscal contraction.

A NOTE ON REPOSSESSIONS

According to the Council of Mortgage Lenders, the number of repossessions fell to 9,800 in the first quarter of 2010, down from 10,600 in the previous quarter and 13,200 in the first quarter of 2009. The proportion of mortgages in arrears also fell. This trend reflects the beneficial influence of low interest rates, Governmental support and lender forbearance. However, we would do well to remember the large number of households, who are just coping, that remain vulnerable to external shocks. There is a clear risk that higher interest rates or unemployment would tip a number of finely-balanced households, who are currently coping, into arrears and would undermine the capacity of struggling households. Any sharp pick-up in repossessions and forced sales would have downward pressure on prices.

A NOTE ON CREDIT

Support provided by the Bank of England to high street banks is about to be withdrawn just as these banks need to start re-financing around £800 billion of loans in the wholesale market by the end of 2012. Currently the banks are refinancing less than half the amount required each month and there are serious fears that Britain is facing the threat of a second credit crunch. The latest Bank of England Credit Conditions report showed that more banks thought that lending would fall rather than rise by September, for the first time since the end of 2008. These tightening credit conditions are occurring just as the government are putting pressure on banks to lend more.

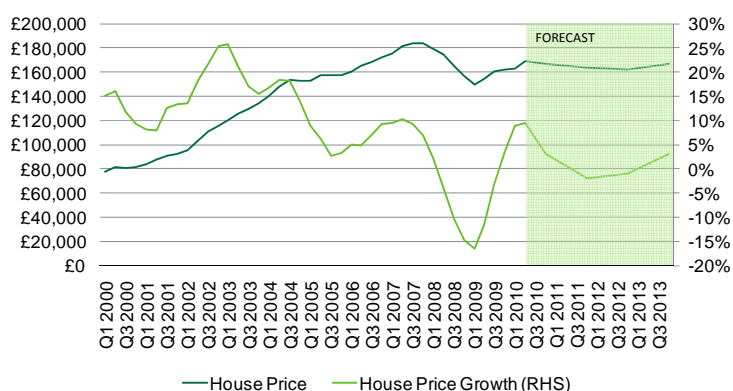
INCOME

Earnings have been growing very slowly over the last two years and nominal growth is not expected to pick up very much going forward, reaching 3.3% by 2013. However, allowing for inflation, real earnings are expected to fall at least until the middle of 2013 - The RPI reached 5.1% in May and is likely to fall back slowly and plateau at around 3% in 2013.

At the same time, the average household will lose over £400 per year through the changes to the tax and benefit system.

The squeeze on incomes will have considerable implications for those looking to enter the housing market; making it both harder to save for a deposit and to service the monthly mortgage payments. This will act as a brake on demand and house price growth.

Chart 1: UK House Price Forecasts



Source: Nationwide; CB Richard Ellis

UNEMPLOYMENT

The Chancellor announced real terms cuts across all government departments of 25% over four years – except for health and foreign aid which are ring-fenced. Some departments have been asked to consider cuts of up to 40% in order to reduce the deficit. These spending cuts taking place across the public sector will affect the private sector as contracts are pulled and/ or re-negotiated.

There is no doubt the cuts will feed through to major public sector unemployment. This could lead to an increase in repossessions as those made redundant fail to pay their mortgage instalments and find the mortgage safety nets provided by the government are no longer in place.

The overall impact will depend on the scale of public sector job losses and the extent to which these are offset by employment expansion in the private sector. Private job growth is likely to lag an economic upturn so unemployment may not be on a downward trend until 2012.

A NOTE ON HOUSEBUILDING

Levels of house building have a limited impact on house prices in the short and medium term, instead economic and political factors have a more direct effect. However, the supply of housing is fundamental to house prices in the long term. House building levels are currently at historic lows and completions are expected to remain at these historic lows at least until 2012. For example, according to Experian in 2007 there were 182,000 private housing completions and in 2012 only 100,000 completions are forecast; a 45% drop. This could mean that as the market and economic fundamentals improve the underlying shortage of housing will once again drive capital growth in the housing market.

CONFIDENCE

Consumer confidence plays a major part in the performance of the housing market, but is a relatively difficult variable to measure. However, the various indices showed rising confidence in the first quarter of 2010, but in recent months it has been falling away. This is no surprise considering the post election gloom and subsequent economic fears.

As household finances are increasingly exposed to the fiscal squeeze and the prospect of increasing unemployment through the rest of 2010 and into 2011, we expect confidence will weaken further. When confidence is low, decisions concerning major investments such as buying a house, tend to be put off. As a result demand for housing is likely to also falter in the second half of this year and into 2011. This will also lead to further falls in transactions.

REGIONAL VARIATIONS

Nationally, our forecast shows house prices rising by 3% in 2010 overall. As might be expected there is a considerable regional variation in house price growth forecasts. House price growth is expected to range between -4.5% in Northern Ireland and 8.6% in London in 2010.

In 2011 London is expected to out perform the other regions. This is partly due to its attractiveness to international buyers which is being fuelled by the weakness of pound and supporting prime Central London prices in particular. Also as the country's financial and economic capital, London exerts a major pull on people looking for work not just from other regions of the UK but also from across the world. The underlying supply and demand imbalance in London will cushion it from the larger price falls that will be seen elsewhere.

Wales, the Midlands, the North West and Yorkshire and Humberside will be hit hardest by the downturn. This is partly because many of these areas contain cities which are heavily reliant on the public sector for employment and so will be hit by the government cuts. For example, the public sector employs over 40% of Liverpool's total workforce. This in turn could lead to a greater concentration of repossessions and a stronger downwards pull on house prices, when compared with southern regions.

Of all the regions, Northern Ireland will fare the worst in 2010. It was the only region in the last quarter to record house price falls, and has failed to show signs of any confidence returning to the housing market.

REGIONAL FORECASTS

UK	
2010 House Price	£166,980
Annual Growth 2010	3.0%
Annual Growth 2011	-2.0%

NORTHERN IRELAND	
2010 House Price	£131,675
Annual Growth 2010	-4.5%
Annual Growth 2011	-0.9%

NORTH WEST	
2010 House Price	£141,592
Annual Growth 2010	1.3%
Annual Growth 2011	-6.6%

WEST MIDLANDS	
2010 House Price	£148,072
Annual Growth 2010	2.3%
Annual Growth 2011	-5.4%

WALES	
2010 House Price	£134,870
Annual Growth 2010	-0.7%
Annual Growth 2011	-7.1%

SOUTH WEST	
2010 House Price	£188,905
Annual Growth 2010	5.3%
Annual Growth 2011	-2.5%

SCOTLAND	
2010 House Price	£146,937
Annual Growth 2010	4.7%
Annual Growth 2011	2.7%

NORTH	
2010 House Price	£118,490
Annual Growth 2010	2.0%
Annual Growth 2011	-1.8%

YORKS & H'SIDE	
2010 House Price	£139,394
Annual Growth 2010	1.5%
Annual Growth 2011	-5.2%

EAST MIDLANDS	
2010 House Price	£139,899
Annual Growth 2010	2.5%
Annual Growth 2011	-5.1%

EAST ANGLIA	
2010 House Price	£168,309
Annual Growth 2010	5.2%
Annual Growth 2011	0.6%

LONDON	
2010 House Price	£299,887
Annual Growth 2010	8.6%
Annual Growth 2011	2.5%

OUTER METROPOLITAN	
2010 House Price	£250,299
Annual Growth 2010	7.8%
Annual Growth 2011	1.3%

SOUTH EAST	
2010 House Price	£202,885
Annual Growth 2010	6.0%
Annual Growth 2011	-0.5%

CONCLUSION

Although we do not expect a "double dip" housing market recession, our analysis suggests a protracted period of weakness with minor house price falls over the next two and a half years.

In the short-term this reflects a combination of dented confidence resulting from a realisation (on the back of the emergency budget) of the full extent of economic weakness and budget deficit and continued mortgage market constraints. In the medium-term it reflects the impact of the £113bn fiscal tightening and our assumption that interest rates will rise.

By 2013, the effects of the fiscal squeeze and unemployment will have peaked and start to unwind, leading to improved market activity. By 2014, we expect the housing market to be in a fully fledged recovery phase. However, it is unlikely that house prices will reach the highs seen at the peak of the market until 2015/16.

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HOUSE PRICE INDICES

	M-on-M	Q-on-Q	Y-on-Y	Level
Nationwide (May)	0.8%	1.7%	9.8%	£169,162
Halifax (May)	-0.4%		6.9%	£167,570
Land Registry (Apr)	0.2%		8.5%	£165,596
Hometrack (May)	0.2%		2.0%	
CLG (Apr)	0.4%		10.1%	£207,516
Rightmove (Jun)	0.3%		4.3%	£237,767

ACTIVITY INDICATORS

	M-on-M	Q-on-Q	Y-on-Y	Level
Mortgage Approvals (Apr)	1.8%		9.5%	49,871
Gross Mortgage Lending (May)	7.0%		10.0%	£11.3bn
Housing Completions (Q4)				
Housing Starts (Q4)	The DCLG has revised the methodology and historic starts are currently unavailable			

ECONOMIC INDICES

	M-on-M	Q-on-Q	Y-on-Y	Rate
GDP (Q1)		2.0%	3.3%	
CPI (May)	0.0%		3.4%	
RPI (May)	0.0%		5.1%	
Unemployment (Feb 10 to Apr 10)		0.1%		7.9% (2.47 million)

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